No. 87-654

In the Supreme Court of the United States

October Term, 1987

NEW ENERGY COMPANY OF INDIANA,
Appellant,
v.
JOANNE LIMBACH,
TAX COMMISSIONER OF OHIO, MARY ELLEN WITHROW,
TREASURER OF OHIO, and SOUTH POINT ETHANOL,
Appellees.

On Appeal from the Supreme Court of Ohio

APPELLANT'S BRIEF

HERMAN SCHWARTZ*
207 Myers Hall
4400 Massachusetts Ave., N.W.
Washington, D.C. 20016
202/885-2648

DAVID J. YOUNG
MURPHEY, YOUNG AND SMITH
250 E. Broad Street
Columbus, Ohio 43215
614/228-4371
Attorneys for Appellant New Energy Company of Indiana

*Counsel of Record

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
or call collect (402) 342-2831

QUESTIONS PRESENTED

Prior to 1985, Ohio granted a credit to the motor vehicle fuel tax for gasohol, which is a 90-10 blend of gasoline and ethanol. Ohio R.C. 5735.145 (1981). On December 20, 1984, Ohio amended the statute by denying the credit to gasohol containing ethanol produced in another state, unless the producer state grants a credit to gasohol sold there containing Ohio-produced ethanol. Ohio R.C. 5735.145(B). The credit that Ohio grants out-of-state ethanol is limited to the amount of credit granted Ohio ethanol in the other state.

The following questions are presented by this appeal:

1. Does the Commerce Clause allow Ohio to insist on such forced reciprocity even if, as the trial court found, its practical effect is to bar and/or remove from the Ohio market ethanol produced in those states that choose not to give such a credit?

2. Is a forced reciprocity provision enacted for the purpose of promoting domestic industry and to induce other states to grant reciprocal tax credits consistent with the Commerce Clause?

3. Is the forced reciprocity provision constitutional because at least some of the ethanol produced outside Ohio is eligible for the tax credit and can enter the Ohio market, even though because of that provision, ethanol produced in many other states cannot?

TABLE OF CONTENTS

TABLE OF AUTHORITIES CITED

TABLE OF AUTHORITIES CITED—Continued

TABLE OF AUTHORITIES CITED—Continued

No. 87-654

In the Supreme Court of the United States

October Term, 1987

NEW ENERGY COMPANY OF INDIANA,

Appellant,

v.

JOANNE LIMBACH,
TAX COMMISSIONER OF OHIO,
AND SOUTH POINT ETHANOL,

Appellees.

APPELLANT'S BRIEF

Appellant New Energy Co. appeals from a final order of the Supreme Court of Ohio, on rehearing, rejecting a challenge to Ohio Revised Code 5735.145(B), an amendment to the Ohio motor fuel tax that was enacted December 20, 1984 and became effective January 1, 1985. The amendment conditioned the grant and amount of a credit to such tax for gasohol containing ethanol produced in a state

other than Ohio, on the availability and amount of a credit for Ohio-produced ethanol in such other state. The Supreme Court of Ohio held that the statute did not violate Article I, sec. 8, cl. 3, the Commerce Clause, of the United States Constitution.

OPINIONS BELOW

The opinion of the Ohio Supreme Court on rehearing is reported at 32 Ohio St. 3d 206, and is reprinted at the Appendix to the Jurisdictional Statement at J. St. App. 1a.[1] The original decision of the Ohio Supreme Court has not been reported and is reprinted at J. St. App. 20a. The opinion of the Tenth Appellate District of the Court of Appeals of Ohio is not officially reported and is reprinted at J. St. App. 35a. The opinion and decision of the Court of Common Pleas of Franklin County, Ohio is not officially reported and is reprinted at J. St. App. 56a.

JURISDICTION

The Ohio Supreme Court rendered its opinion and entered a final judgment on rehearing on September 2, 1987. A Notice of Appeal to this Court was timely filed with the Ohio Supreme Court on October 9, 1987, and the

[1]References to the Appendix to this brief are "App. —"; to the Joint Appendix "JA —"; and to the Appendix to the Jurisdictional Statement "J. St. App."

appeal docketed within 90 days of the rendering of the Ohio Supreme Court's decision and judgment on rehearing. A jurisdictional statement was filed on October 22, 1987 and probable jurisdiction noted on December 14, 1987. The jurisdiction of this Court is invoked under 28 U.S.C. sec. 1257(b).

CONSTITUTIONAL PROVISION AND RELEVANT STATUTES

Article I, sec. 8, cl. 3 of the United States Constitution provides that:

1. The Congress shall have power . . . to regulate commerce with foreign nations, and among the several States, and with the Indian tribes.

Ohio Revised Code 5735.145(B) (1984) provides that:

(B) The qualified fuel otherwise eligible for the qualified fuel credit shall not contain ethanol produced outside Ohio unless the tax commissioner determines that the fuel claimed to be eligible for credit contains ethanol produced in a state that also grants an exemption, credit or refund from such state's motor vehicle fuel excise tax or sales tax for similar fuel containing ethanol produced in Ohio; provided however, that such credit shall not exceed the amount of the credit allowable for qualified fuel containing ethanol produced in Ohio.

The full text of R.C. 5735.145, as amended in 1984, is in the Appendix to this brief.

STATEMENT OF THE CASE

This is an appeal from a decision by a 4-3 majority of the Supreme Court of Ohio, on rehearing, upholding an Ohio tax statute, Ohio Rev. Code § 5735.145(B) against a challenge under the Commerce Clause of the United States Constitution, Article I, § 8, cl. 3. The decision overturned a prior decision of the Ohio Supreme Court that had struck down the statute by a 4-3 majority. The case involves state tax incentives for the use of ethanol in gasoline and the denial of the Ohio tax credit for ethanol produced in other states, unless the latter provide Ohio-produced ethanol sold there with a credit.

The Product

Ethanol is an ethyl alcohol, almost 200 proof, derived primarily from corn; a bushel of corn yields approximately 2½ gallons of ethanol. The corn is treated with enzymes that convert the starch into sugar and ultimately into alcohol. Ethanol is also obtainable from sugar cane, sugar beets, wheat, molasses and virtually any raw material containing carbohydrates. It can serve as an automotive fuel, and has gained increasing use as an octane enhancer in place of lead, in a 90:10 gasoline to ethanol ratio. The blend is commonly known as "gasohol".

The Industry and the Market

Although alcohol fuels were marketed as early as the 1920's, the uses of ethanol as a motor fuel first became a serious possibility in the mid-1970s, as a result of the energy crisis. Ethanol, however, is generally more expensive than gasoline, and the federal government therefore created a variety of economic incentives to its use. First, Congress enacted P.L. 95-617, the Energy Tax Act of 1978,

which exempts fuels containing 10% or more of alcohol produced from renewable resources from 4¢ per gallon of the federal excise tax on gasoline. According to the Congressional Research Service, "This legislation made the use of 'gasohol' economically competitive; [and] the blend began appearing on the market in 1979." Siegel, Carr, Gelb & Melke, *Analysis of Possible Effects of H.R. 2052, Legislation Mandating the Use of Ethanol in Gasoline*, Cong'l Research Service Report for Congress 87-819 SPR, p.6. (Oct. 13, 1987). ("CRS Study")

The federal government followed the excise tax exemption with tax credits for blenders and other uses of alcohol, P.L. 96-223 (1980); loan guarantees, price guarantees, purchase agreements, and research, P.L. 96-294, (1980); a tariff on imported fuel ethanol (Brazil was of particular concern), P.L. 96-499 (1980); encouragement of the use of surplus stocks, P.L. 97-358 (1982); and increases in the excise tax exemption to 6¢ out of 9¢, P.L. 98-369 (1984). In 1987, the excise tax exemption was extended to 1993. P.L. 100-17.

Many states, particularly in the heavy grain-producing areas in the Midwest, also provided incentives of various kinds. Thirty-two states ultimately provided some form of sales tax reduction and eight states provided producer incentives. The states that provided incentives and the amounts, in January 1985 and in October 1987, are set out in maps appended to this brief. App. 1a, 2a. Some nine states require reciprocity in addition to Ohio, but of those, four states do not enforce it because of an Attorney General Opinion or court ruling that reciprocity is unconstitutional. (Tennessee, Idaho, Alabama and Illinois).

The pricing of gasohol and its relation to the federal and state sales tax exemptions are illustrated in Plaintiff's Exs. 5 and 6, JA 147-48. As explained at the hearing, if, for example, ethanol costs $1.32 per gallon, and the dealer or jobber must be paid approximately 20¢ per gallon of ethanol to compensate him for blending, then 10% of the ethanol gallon costs 15.2¢ (13.2+2). If, as was true in 1984-85, the wholesale price of gasoline is approximately 73¢ a gallon, then 10% of a gallon of ethanol is approximately 7.9¢ more than the 10% gasoline that it displaces in a gallon of gasohol. (15.2 against 7.3) The 6¢ federal tax credit covers most of this, and the state tax credit may cover the rest, although freight costs—approximately 6¢ per gallon of ethanol, or .6¢ per 10%—consume some of this. Plaintiff's Exs. 5-7 explain this with respect to Ohio in 1985.[2]

In addition to providing a potentially huge new market for corn, see CRS Study 11, 71 (potentially 1.7 billion bushels per year by 1992) ethanol also is environmentally benign, decreasing carbon monoxide emissions. This is a special problem for Western States. Some questions have recently been raised, howevver, about its effect on ozone in certain areas. See generally CRS Study 46, 67-80.

---

[2]The retail price of a gallon of 100% gasoline was $1.58, or 15.8¢ per 10%. The price of 10% of a gallon of ethanol, after allowing for the federal and Ohio credits, is 13.8¢. The 2¢ per gallon difference is necessary to induce a dealer to use ethanol. Without the Ohio credit, the equivalent wholesale price of gasohol is a half cent more than gasoline. At this price, ethanol is unattractive to the dealer, since differences of a cent or more per gallon are significant because of volume. JA 76-77

The cost of producing ethanol, as set out in the exhibit, factors in revenues from by-products from the production of ethanol.

In 1985, the ethanol industry received an additional boost when the Environmental Protection Agency ordered the gradual elimination of lead from gasoline. 40 CFR Part 80. Lead is an octane enhancer, and its removal requires the substitution of other enhancers, which can be either oxgenates such as ethanol, methyl tertiary butyl ether, methanol and tertiary butyl alcohol, or aromatics like toluene, bensene and xylene. Octane can be enhanced also by increasing refining severity through processing gasoline feed stocks at higher temperatures. Some of these products and processes can be produced or done by the oil companies themselves.

Until the lead reduction requirements and the need for alternate octane enhancers, the oil companies generally opposed the use of ethanol, since it replaced some of the oil companies' gasoline with a grain product produced by others; many still do. Many oil companies therefore opposed the grant of ethanol incentives. See JA 69, 91-92, 102. See, *e.g.*, *Alcohol Update*, Jan. 26, 1987, p.1 (Congressmen protest to Federal Trade Commission about anti-ethanol ads by major oil companies); Feb. 23, 1987, p.3 (Louisiana anti-ethanol campaign); Jan. 19, 1987, p.1 (American Petroleum Institute Committee formerly opposed, but will study further.) See also *Amicus Curiae Brief for Marathon Petroleum Company Urging Reversal* in *New Energy Co. v. Limbach*, Sup. Ct. Ohio, p.1.

Despite these and other problems—*e.g.* consumer acceptance, freight costs (JA 63) — the ethanol market has continued to grow, stimulated especially by farmers' economic problems. Ethanol fuel consumption has grown from 0 in 1978 to some 750-800 million gallons/year in 1986-87 with ethanol blends accounting for approximately

8% of United States gasoline consumption. New plants are being built throughout the nation, see *Alcohol Update* Dec. 14, 1987, p.1.; Nov. 30, 1987, p.1.; Nov. 23, 1987, p.1, even though many states have been phasing out or reducing their tax credit. See, *e.g.*, Michigan, Colorado, Illinois, Indiana, Florida. Ohio plans to do likewise. Indeed, ethanol use has grown even in states without the state tax credit. Colorado has mandated its use, Information Resources, Inc., *U.S. Motor Fuel Legislative and Regulatory Service-Colorado* (1987) and other states are considering similar measures, in whole or in part. See *Alcohol Update*, March 9, 1987 (Minn.), July 20, 1987 (Iowa). As of October, 1987 "the leading states in blend sales were Illinois, Ohio, Kentucky, Indiana and Iowa, in that order: leading states in terms of market share were Kentucky, Iowa, Nebraska, Illinois and Indiana in that order." CRS Study 4. According to an industry spokesman, ethanol accounted for 38.7% of the motor fuels used in Kentucky, 27.8% in Iowa, 27.4% in Nebraska, 27.2% in Illinois and 22% in Indiana. Testimony of Eric Vaughn before the House Committee on Energy and Commerce, Subcommittee on Energy and Power, June 24, 1987, p. 2(mimeo).

Industry Members

The largest factor in the industry is Archer, Daniels & Midland, which has plants throughout the country and accounted for approximately 50% of ethanol production in 1986. It has plants in Illinois and Iowa, and it sells in Ohio. Pekin Energy Company, owned largely by Texaco and the Corn Products Company with a plant in Illinois, and A.E. Staley, with a plant in Tennessee, but headquartered in Illinois, also produce ethanol, and sell in the Ohio market. JA 77, 122, 126

South Point Ethanol was formed in 1981 to retrofit an existing chemical plant in South Point, Ohio. It is a joint venture among Ashland Ethanol, Inc., the Ohio Farm Bureau, Synfuels Investment Company, Publicker Gasohol, Inc. and UGI Ethanol Development Corp. JA 127-29 It is also the beneficiary of a $23.5 million loan from the Ohio Public Employees Retirement Fund, and has received tax credits for anti-pollution equipment. JA 140

The South Point plant is located in a county with the "second highest rate of unemployment in the state of Ohio"; the highest unemployment rate is in an adjacent county to the north. It employs 191 people, and has 20-40 outside maintenance contractors. Its annual payroll is about $6 million. JA 128 In 1984, it purchased 24,000,000 bushels of corn, largely from Ohio and Indiana, and approximately 180,000 tons of coal. Its 1984 budget was $99.7 million. JA 130 See Def. Ex. C., JA 150.

In March 1985, South Point had a capacity of some 60 million gallons annually and sold primarily in Ohio (41%) and Kentucky, with lesser amounts in Virginia, West Virginia, Tennessee, Indiana, Illinois and Minnesota. In 1984, all these states but Indiana and West Virginia had substantial tax credits. See map in App. 1a. West Virginia, however, produced no ethanol and used almost none.

New Energy Company is the newest of these four producers. It was formed in 1980, and capitalized in 1982 at $185 million, primarily through a $140 million bank loan, 90% of which was guaranteed by the Department of Energy ("DOE") pursuant to the Energy Security Act of

1980. (In 1986, New Energy was forced to default on that loan, and DOE assumed and restructured it; the loan now totals approximately $107 million and is being repaid directly to the United States Treasury) DOE also provided a direct loan, as did the City of South Bend from an Urban Development Action Grant. JA 56-57

Construction of the New Energy plant started in 1982, and it started to produce ethanol in October 1984 with a projected annual capacity of approximately 4.7 million gallons of ethanol per month, and a projected annual capacity of approximately 60 million gallons. By March 1985, it was operating at approximately 75-80% of capacity. JA 56 For freight and tax credit reasons, its primary markets were projected to be Indiana, Illinois and Ohio. In Ohio, it projected ethanol sales of 1.7 million gallons per month, or approximately 20-21 million gallons annually. In March 1985, approximately 20-25% of its sales were in Ohio. JA 63-64

After passage of the reciprocity amendment, New Energy's sales in Ohio fell to virtually nothing and it was forced to incur much higher freight costs in order to sell its product elsewhere. See JA 152, (Affidavit of Donald Evans). Loss of the Ohio credit has excluded New Energy from competing for business in the Ohio market since passage of the amendment, in December 1984, and has caused it serious injury. JA 157-58; J. St. App. 58a, 63a.

The Legislation

In 1984, Indiana adopted legislation establishing a fund, subject to annual appropriation, providing production grants to entities that establish an ethanol plant in a blighted area employing 75 or more employees. Indiana

Code 4-4-10.1-1 (1984 Supp.) The grant is on a per gallon basis, with the amount of the grant to be set each year, up to a maximum; in the first year, the grant was only 10¢ per gallon, though the statutorily permissible amount was 25¢. No money has been appropriated since July 1, 1986, and no grants have been made since then.

As of 1977, Indiana also had a sales tax credit, computed as a percentage of the retail selling price. JA 67-68 In 1984 and January 1985, the credit came to approximately 25¢ per gallon of ethanol. Oil companies, as noted, had consistently opposed incentives for ethanol, as the trial court recognized, JA 102, and despite New Energy's desires to the contrary, see JA 103, succeeded in getting the Indiana sales tax credit repealed, as of July 1, 1985. JA 69

Ohio had also had a sales tax credit, first adopted in 1981, when South Point Ethanol was established. R.C. 5735.145. It was available for all gasohol sales, without distinction as to where the ethanol was manufactured; New Energy had obviously relied on this in planning its marketing. In 1984, the credit was 35% per gallon of ethanol but when the federal exemption was raised that year by 1¢, the Ohio credit was lowered proportionately to 25¢ per gallon, effective February 1985.

But by February 1985, this credit was made conditional on the tax credits available in the place of origin. After the Indiana sales tax repeal statute was adopted, Ohio S.B. 334 was introduced limiting the Ohio tax credit to ethanol produced in states that gave Ohio-produced ethanol a credit for Ohio ethanol sold in those states; moreover, the credit for foreign ethanol sold in Ohio was limited

to the amount of credit the foreign state gave Ohio ethanol, so that if Ohio gives 3.5¢ to Ohio ethanol but Illinois gives only a 1¢ credit, Illinois ethanol gets only 1¢ credit in Ohio. South Point lobbied "heavily for it [the reciprocity amendment] so they would put pressures on Indiana and perhaps [New Energy's President] for some number in Indiana for them at the pump." JA 123 This testimony, (which was never challenged), was reinforced by the testimony of South Point General Manager Lauren Hill. JA 139, 136

As part of his lobbying, Mr. Hill told the Ohio legislature of "the benefits of the South Point Plant," and he "stressed the development of the South Point project and used a table similar to Defendant's Exhibit C. to stress the economic impact of the South Point plant." JA 136

The lobbying was obviously successful, and the tax credit statute was amended to deny some or all of the Ohio tax credit to ethanol produced in any state that did not provide the same level of tax credit for Ohio ethanol as Ohio did. Rev. Code 5735.145(B).

The Ohio credit statute has been amended again. Legislation passed in the 1987 session of the legislation reduced the credit to 20¢ in July 1, 1988, 15¢ on July 1, 1990 and 0 on July 1, 1993. H.B. 419, 1987 Leg. Sess.

The Litigation and Proceedings to Date

Recognizing that the Ohio reciprocity amendment would effectively exclude it from the Ohio market, New Energy sued the State defendants in the Common Pleas Court of Franklin County, and sought a preliminary injunction. A hearing was held on March 1, 1985. South Point Ethanol, asserting it was a necessary party, see

Brief for Appellee South Point Ethanol in Ohio Sup. Ct, pp. 1-2, thereupon intervened, and another hearing was held on March 29, 1985. At New Energy's request, the court agreed to expedite matters, and accordingly issued a ruling on April 23, 1985.

The State Defendants asked the Court to find that

> "It is conceivable that the Ohio General Assembly may have had several purposes in enacting R.C. § 5735.145 (B), none of which were explicitly declared in the enactment itself. One of these purposes was to provide a cleaner and safer environment for Ohio citizens by encouraging the use of ethanol as a replacement for lead gasoline not only in Ohio but in all states."

JA 44

The Court did not adopt this Proposed Finding. Instead, it found that:

> "b. The plaintiff will be significantly damaged by the effect of the legislation;"
>
> "c. The legislature's purpose of promoting domestic industry and to effect the policies of other state to grant reciprocal tax credits, is a legitimate purpose—at least debateably . . ."

J.St. App. 63a.

The Court also found that "plaintiff is the only producer affected and it would not have been affected if its state legislature had not abolished its tax credit." While noting that "this is a very close case," the court concluded: "Remembering that the legislation receives a strong presumption in favor of its constitutionality, this Court holds that it does not violate the Commerce Clause of the United States Constitution." J. St. App. 65a.

New Energy appealed immediately, but partly because of the death of a judge in August 1985, the Court of Appeals did not rule until May 8, 1986, despite its having granted a motion to expedite. It affirmed the trial court by a 2-1 ruling holding that the Ohio statute did not discriminate but treated all ethanol even-handedly. One judge dissented. See J. St. App. 35a-54a.

New Energy promptly requested the Ohio Supreme Court to review the case, and on an expedited basis. The Court agreed, and on December 26, 1986, in a 4-3 decision, found that the Ohio statute was a forced reciprocity statute that discriminated against out-of-state products.

In the preceding election, however, (November, 1986), two of the incumbent justices, both of whom had been in the majority, were not re-elected. Shortly after the newly elected justices took office, South Point Ethanol moved for a rehearing. The vote of four justices is required for rehearing, and the three dissenters were joined by the newly elected Chief Justice Thomas Moyer in voting for rehearing.[3] Shortly thereafter, certain conflict of interest questions were raised about Chief Justice Moyer's participation in the *New Energy* case, and he recused himself from participating in the rehearing.[4] He denied a motion, however, to disqualify himself *nunc pro tunc;* had he granted the motion, he would not have sat on the motion for rehearing, which would have precluded the requisite four votes.

---

[3]The other newly elected justice followed the normal practice that a judge not on the court when a case is decided, does not vote on the petition for rehearing.

[4]The details are set forth in the Akron *Beacon-Journal*, March 4, 1987, and March 5, 1987.

On September 2, 1987, two and a half years after the action was instituted, a new 4-3 majority disagreed with the Ohio Supreme Court's prior opinion, and upheld the statute on the ground that it was "not protectionist in purpose or effect," and "it does not interfere with the free flow of interstate commerce," J. St. App. 4a, even though "New Energy is adversely affected." J. St. App. 4a. While it found "the issue of forced reciprocity . . . a thorny problem," J. St. App. 8a, the majority concluded that because "the bulk of ethanol and gasoline sold in Ohio is obtained primarily . . . from Illinois and Tennessee," J. St. App. 9a, and there was not "a complete bar to interstate commerce," J. St. App. 10a, the statute was constitutional. Three justices dissented.

This appeal followed.

SUMMARY OF ARGUMENT

1. In an unbroken line of decision, this Court has ruled that mandatory reciprocity laws are facially discriminatory and barred by Article I, section 8, cl. 3 of the United States Constitution, the Commerce Clause. *Sporhase v. Nebraska ex rel. Douglas*, 458 U.S. 941, 957 (1982); *Great A&P Tea Co. v. Cottrell*, 424 U.S. 366 (1976) ("A&P"); cf. *Baldwin v. G.A. F. Seelig, Inc.*, 294 U.S. 511 (1935).

The 1984 forced reciprocity amendment to the Ohio ethanol tax credit is facially discriminatory in the same way, and similarly prohibited by the Commerce Clause. The amendment cannot be upheld simply because a few

other states have such a provision, nor because ethanol from these other states is still eligible to come into Ohio on an even basis. This Court has struck down under the Commerce Clause many statutes that do not impose or produce a complete ban on all out of state business, whether those statutes are absolute bars, as in *A&P*, or discriminatory taxes. This is because mandatory reciprocity creates "preferential trade areas [that are] destructive of the very purpose of the Commerce Clause." *A&P*, 424 U.S. at 380. In this case an Indiana competitor of an Ohio company was effectively ousted from the Ohio market because of the discriminatory tax credit, and there is nothing in the record or any other reason, to think that the sales that the Indiana company might have received did not go to the Ohio competitor, the intervenor-appellee.

2. The Ohio mandatory reciprocal amendment is not justified by a constitutionally valid purpose. The Ohio courts found that the purposes of the amendment were "promoting domestic industry *and* to affect the policies of other states to grant reciprocal tax credits," J.St. App. 63a (emphasis in original). These purposes cannot be furthered by discriminatory legislation. The first purpose, "promoting domestic industry" was clearly intended to assist South Point Ethanol, and such domestic protectionism is clearly unconstitutional. The other purpose, "affecting" the policy of Indiana in order to persuade it to grant reciprocal tax benefits to an Ohio company, is an illegal purpose when sought through discriminatory or other coercive means. Ever since *Baldwin v. Seelig*, it has been undisputed that a state "has no power to project its legislation" into another state to force the latter to adhere to the first state's policies. 294 U.S. at 521. While reciprocity

may be acceptable, "forced reciprocity" is not. *A&P*, 424 U.S. at 378-80. "One state may not put pressure of that sort upon others to reform their economic standards." *Baldwin v. Seelig*, 294 U.S. at 524. If Ohio is unhappy with any action taken by the Indiana legislature, its remedy is not economic retaliation but a lawsuit.

Nor can it be argued that this statute was for the purpose of promoting the health of people in Ohio. There is no record evidence of that and the Ohio courts declined to make such a finding. The limitations that Ohio has put on its tax credit, with respect to not only the source of the ethanol but also with respect to the raw materials from which it is made and the fuel which may be used, also indicate that promoting health by encouraging the use of ethanol was not a significant purpose. Moreover, at the time that the reciprocity amendment was adopted, all the states adjacent to Ohio which might be the source of unhealthy conditions already gave tax credits or other incentives to ethanol production and use.

3. The effect of Ohio R.C. 5735.145(B) is to burden commerce excessively. The Ohio trial court found, and it is undisputed, that the amendment effectively excludes appellant New Energy from the Ohio market, and this has adversely affected it. The fact that other out-of-state producers continue to operate in Ohio is irrelevant.

———o———

ARGUMENT

I. OHIO R.C. 5735.145(B), THE 1984 AMENDMENT TO THE OHIO ETHANOL TAX CREDIT STATUTE ADDING A FORCED RECIPROCITY CONDITION, CONFLICTS WITH THE DECISIONS OF THIS COURT UNDER THE COMMERCE CLAUSE.

In an unbroken series of decisions on state reciprocity provisions similar to the one at bar, this Court has made it clear that mandatory reciprocity provisions are "facially discriminatory" and are subject to "the strictest scrutiny". *Sporhase v. Nebraska ex rel. Douglas*, 458 U.S. 941, 957 (1982). See also *Great A&P Tea Co. v. Cottrell*, 424 U.S. 366 (1976); *cf. Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511 (1935). They are "explicit barrier[s] to Commerce between . . . states." *Sporhase v. Nebraska*, 458 U.S. at 957. Not only are such statutes facially discriminatory, they are coercive and protectionist. See Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause*, 84 Mich. L. Rev. 1091, 1272-73, (1986) ("There are not many techniques for forcing locals' interests in foreign markets. But reciprocity requirements are such a technique. When a coercive technique appears by which a state can pursue local preference in regard to foreign markets, use of the technique is no less objectionable just because the market in question is foreign.") See also Smith, *State Discriminations Against Interstate Commerce*, 74 Calif. L. Rev. 1203, 1246 (1986) (facial discrimination subject to strict scrutiny regardless of proof of purpose).

The relevant law on barriers to interstate commerce was summarized by the Court two terms ago in *Brown-Forman Distillers Co. v. N.Y. State Liquor Authority*, 106 S. Ct. 2080, 2084 (1986) as follows:

> "When a state statute directly regulates or discriminates against interstate Commerce, or when its effect is to favor in-state economic interests over out-of-state interests, we have generally struck down the statute without further inquiry. [citations omitted] When, however, a statute has only indirect effects on interstate commerce and regulates evenhandedly, we have examined whether the State's interest is legitimate and whether the burden on interstate commerce clearly exceeds the local benefits. *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142, 25 L.Ed.2d 174, 90 S.Ct. 844 (1970). We have also recognized that there is no clear line separating the category of state regulation that is virtually per se invalid under the Commerce Clause, and the category subject to the *Pike v. Bruce Church* balancing approach. In either situation the critical consideration is the overall effect of the statute on both local and interstate activity."

The Court's clearest and most recent statement on reciprocity is in *Sporhase*, where the Court voided a Nebraska law that conditioned withdrawal of local ground water to another state on the destination state's granting of reciprocal rights of withdrawal into Nebraska. Despite the Court's recognition of Nebraska's "legitimate reasons" based on the need "to conserve and preserve for its own citizens this vital resource in times of severe shortage", as well as many other reasons for the Court to sustain the Nebraska statute, the Court found the reciprocity provision to be "facially discriminatory" and subjected it to the strictest scrutiny, which the provision failed to pass.

The Court showed the same hostility toward forced reciprocity in *A&P*, a case very similar to this one. There,

Mississippi allowed milk from another state to be sold in Mississippi only if the other state "accepts Grade A milk and milk products produced and processed in Mississippi on a reciprocal basis." 424 U.S. at 367. When Mississippi tried to defend its statute by claiming it was only trying to protect the health of its citizens, the Court unanimously replied, "To allow Mississippi to insist that a sister State either sign a reciprocal agreement acceptable to Mississippi or else be absolutely foreclosed from exporting its products to Mississippi would plainly invite a multiplication of preferential trade areas destructive of the very purpose of the Commerce Clause. *Dean Milk*, 340 U.S., at 356." 424 U.S. at 380. See also *Russell Stewart Oil Co. v. Illinois*, 85 CH 8959 (Cir. Ct. Cook Cty. May 7, 1986), *appeal pending;* opinions of Attorneys General of Tennessee and Ilinois, J. St. App. 68a-77a, and of Idaho and Alabama, *Alcohol Update*, Dec. 21, 1987, p. 2.

The 1984 reciprocity amendment to the Ohio ethanol tax credit is similarly "facially discriminatory" and, as the Ohio Supreme Court acknowledged, is subject to the "strictest scrutiny," J. St. App. 8a, citing *Hughes v. Oklahoma*, 441 U.S. 322 (1979), and *Sporhase*. Like the Mississippi and Nebraska statutes, Ohio explicitly treats out-of-state goods worse than those manufactured in Ohio, unless the other state provides Ohio goods, *i.e.*, South Point ethanol, precisely what Ohio wants to the penny—in this case, a tax credit for ethanol at least equal to that which Ohio gives to ethanol produced by South Point.

The Ohio Supreme Court nevertheless upheld the forced reciprocity provision, apparently on two grounds: The first is that "most of the states near Ohio have reciprocal tax credit program, as did Indiana recently . . . [and] if New Energy is successful . . . each state's reciprocal tax program would fall like a row of dominoes." J. St. App. 8a-9a.

Apart from the fact that only a few states have *reciprocity* statutes—the rest give credits but do not exact reciprocity and of the handful that do, only a few, *e.g.*, Ohio, Kentucky and Texas fully enforce the reciprocity agreement[5]—the constitutional significance of this is unclear since "about thirty states" have no greater right to discriminate and force reciprocity on the other twenty, than one state may, with respect to the other forty-nine.

The Ohio Supreme Court's second and weightier reason is its observation that:

> "the bulk of ethanol and gasohol sold in Ohio is obtained primarily through interstate commerce, whereby ethanol is shipped into Ohio from Illinois and Tennessee. Thus, New Energy's inability to compete in the Ohio market will not affect the flow of ethanol through interstate commerce into Ohio." J. St. App. 9a.

But this Court has struck down under the Commerce Clause many statutes that do not impose or produce a complete ban on all out-of-state business. The Court explicitly noted in *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 146 (1970), that only one company, and not the entire industry was affected. In *Hunt v. Washington Apple Advertising Comm'n*, 432 U.S. 333 (1977), the impact on the products

[5]Illinois, Alabama, Idaho and Tennessee do not. See Information Resources, Inc., *U.S. Motor Fuel Legislative and Regulatory Service* (1987); *Alcohol Update*, Dec. 21, 1987, p.2. Indiana never had a reciprocity requirement.

of only one state—Washington—was at issue. In *Lewis v. BT Investment Mgrs., Inc.*, 447 U.S. 27, 32, 39-40 (1980), the statute was actually aimed at only one company. And in *A&P*, Louisiana milk was largely[6] excluded, but some eight states had reciprocity agreements with Mississippi and milk from those states was able to come into Mississippi. *See* Brief of Appellee in *A&P* 6-7. *See also Miller v. Publicker Industries, Inc.*, — Fla. —, 457 So. 2d. 1374 (Fla. S. Ct. 1984) (foreign producers excluded, but not domestic out-of-state companies).

The speculative assertion that New Energy's exclusion from the Ohio market "will not affect the flow of ethanol" into Ohio—which is mere speculation without any record support whatsoever—is particularly inappropriate in a Commerce Clause challenge to a reciprocity provision. Reciprocity creates preferential trade enclaves, in which firms from other states may enter, or compete on an equal footing with the in-stater, only in return for favorable treatment for the in-stater in those other states. Thus, if Indiana gives no credit, Illinois gives only a 1¢ credit, and Ohio and Kentucky each give a 4¢ credit, then (1) Indiana businesses are at a competitive disadvantage in the other three states; (2) Illinois businesses would be able to compete on an even basis only in Indiana and Illinois; and (3) Ohio and Kentucky businesses will have an advantage in the Ohio and Kentucky markets. *See also Halliburton Oil*

[6]Because of a "grandfather clause", even some milk from Louisiana and Alabama which had no reciprocity agreements with Mississippi continued to come in. *Great A&P Tea Co. v. Cottrell*, 383 F.Supp. 569, 572 (1974). This is another instance where the Ohio Supreme Court was factually mistaken. J. St. App. 11a ("no Louisiana milk entered Mississippi".)

Well Cementing Co. v. Reily, 373 U.S. 64, 72 (1973); *Columbia Steel Co. v. State*, 30 Wash. 2d 658, 662-64 (1948), cited in *Armco v. Hardesty*, 467 U.S. 638, 645 n.8. (1984). Such "preferntial trade areas [are] destructive of the very purpose of the Commerce Clause." *A&P*, 424 U.S. at 380. See also *Dean Milk Co. v. Wisconsin*, 340 U.S. 349, 356 (1951).[7]

The discriminatory effect of the Ohio reciprocity statute is clear: an Indiana competitor of an Ohio company was ousted from the Ohio market. Speculation as to who took that share is baseless and immaterial, for regardless of the *capacity* of other interstate competitors, who were expanding their business in other states, there is no evidence for believing that ADM or Pekin, rather than South Point, got New Energy's business. To the contrary, Marathon Oil Co. advised the Ohio Supreme Court, in its *amicus curiae* brief, that it wanted to buy from an Indiana producer, because "transportation logistics and expense" precluded it from buying from producers in Tennessee, Kentucky and Illinois. *Amicus Curiae Brief of Marathon Petroleum Co. Urging Reversal*, p.4. The only alternative ethanol source was South Point. Unlike *Exxon*, where a dealer could buy oil and gasoline *only* in interstate com-

[7]Mandatory reciprocity has also been struck down under the Privileges and Immunities Clause, Art. IV, § 2, *Austin v. New Hampshire*, 420 U.S. 656, 666-67 (1975); *Travis v. Yale & Towne Mfg. Co.*, 252 U.S. 60, 82 (1970), and though that clause is not applicable to this case, the goals of the Privileges and Immunities Clause are similar to those of the Commerce Clause. See *Hughes v. Oklahoma*, 441 U.S. 322, 334 (1979); *Hicklin v. Orbeck*, 437 U.S. 518, 531-32 (1978); *Baldwin v. Montana Fish & Game Comm'n*, 436 U.S. 371, 379 (1978).

merce, here at least some customers could turn to a domestic competitor like South Point.

As the Court noted in *Exxon*, "if the effect of a state regulation is to cause local goods to constitute a larger share, goods with an out-of-state source to constitute a smaller share, of the total sales in the market—as in *Hunt*, 432 U.S., at 347, 97 S.Ct., at 2443 and *Dean Milk*, 340 U.S., at 354, 71 S.Ct., at 297—the regulation may have a discriminatory effect on interstate commerce." 437 U.S. at 126 n.16. Here, there is no reason not to think that the result of the reciprocity amendment was what one would normally expect: that "the effect of [Ohio R.C. 5735.145(B)] is to cause local goods to constitute a larger share, and goods with an out-of-state source to constitute a smaller share" of the Ohio ethanol market.

The Ohio Supreme Court also seemed to suggest that prior decisions of this Court banning the kind of legislation represented by the Ohio reciprocity amendment, were somehow inapplicable because in those cases the "ban" on interstate commerce was in the form of an absolute prohibition on entry, whereas here it is in the form of a discriminatory tax. But this Court has rejected any distinction between (a) taxes that make out-of-state entry difficult or impossible, on the one hand, and (b) absolute bans, on the other, and has treated the two forms of barrier identically. *See Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1979). In *Nippert v. Richmond*, 327 U.S. 416, 426 (1946) discussing barriers to entry the Court said, "Nor may the prohibition be accomplished in the guise of taxation, which produces the excluding or discriminatory effect." *See also*, *Bacchus Imports Ltd. v. Dias*, 468 U.S. 263 (1984); *Welton v. Missouri*, 91 U.S. 272 (1876); *Darnell & Sons v. Memphis*, 208 U.S. 113 (1908); *Best & Co. v. Maxwell*, 311 U.S. 454 (1940); *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64 (1963). As Chief Justice John Marshall said over 150 years ago, "The power to tax is the power to destroy," *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 431 (1819), and here Ohio's tax has destroyed New Energy's ability to compete in the Ohio market.

That the discrimination is in the form of a credit is equally immaterial. *Westinghouse Elec. Corp. v. Tully*, 466 U.S. 388, 404-05 (1984). The trial court found, and it is undisputed, that Ohio's forced reciprocity amendment has a "major impact on its [plaintiff's] business in Ohio . . . [for] in all likelihood, no dealer will purchase plaintiff's product because it is not subject to the tax credit." J. St. App. 58a, 62a; see also the Ohio Supreme Court's reference to "New Energy's inability to compete in the Ohio market." J. St. App. 9a. That is sufficient. See *Brown-Forman Distillers Co. v. N.Y. State Liquor Authority*, 106 S. Ct. at 2084, ("the critical consideration is the overall effect on both local and interstate activity"). As the dissent below observed:

> In numerous cases, the United States Supreme Court has invalidated discriminatory state taxes without requiring that they be so drastic as to erect an impenetrable barricade to Commerce at the state border. *See, e.g., Tyler Pipe Industries, supra; Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984); *Armco, supra; Mary-*

land v. Louisiana, 451 U.S. 725 (1981); *Boston Stock Exchange, supra.*[3]

---

[3]State regulations, as opposed to taxes, also need not effect a total ban upon importation to impermissibly burden or discriminate against interstate Commerce. *See Hunt v. Washington State Apple Advertising Comm.*, 432 U.S. 333 (1977), wherein the Court invalidated a facially neutral North Carolina statute requiring closed containers of out-of-state apples to bear no quality grade markings showing other than the applicable federal grade. Such regulation plainly did not completely ban the importation of out-of-state apples, but it did put their growers at a competitive disadvantage.

J. St. App. 17a-18a.

Such a "competitive disadvantage" on some out-of-state businesses, or the deprivation of a competitive advantage, *Hunt*, 432 U.S. at 351, *Baldwin v. Seelig, supra*, is enough to condemn a statute.

Nor is it relevant how great the disadvantage. As this Court said in *Westinghouse Elec. Corp. v. Tully*, 466 U.S. at 407:

> When a tax, on its face, is designed to have discriminatory economic effects, the Court "need not know how unequal the tax is before concluding that it unconstitutionally discriminates." *Maryland v. Louisiana*, 451 U.S. [725] at 760.[13]

---

[13]The extent of the discrimination does not affect our analysis.

Reciprocity requirements also have an additional vice, noted by the Attorney General of Tennessee in his opinion ruling that an ethanol reciprocity tax credit statute is unconstitutional: "The reciprocity statute does not mitigate the possibility of discrimination against interstate Commerce because gasohol manufacturers do not dictate their states' taxation structures," J. St. App. 71a, (though

events in Ohio suggest the possibility that this is not always so.) New Energy was dismayed by the Indiana decision to repeal the ethanol tax credit, and its trial counsel noted its unhappiness. JA 69, 103 Similarity, "A&P attempted but failed to obtain the required reciprocity agreement from the Louisiana health authorities." 424 U.S. at 369 n.1.

This helplessness makes it particularly inappropriate for the Ohio Supreme Court and the lower courts to declare that if Indiana chose to repeal its credit and provide production grants, and "an Indiana energy producer is put at a disadvantage in maintaining its share of the Ohio market, so be it." J. St. App. 9a.[8] See also the lower court suggestions to the same effect. J. St. App. 45a-46a; 65a. This Court was obviously not impressed with such arguments when they were made in *A&P*, *see Great A&P Tea Co. v. Cottrell* 383 F. Supp. 569, 575 n.2 (S.D. Miss. 1874) (3 judges), and they are no more impressive here.[9]

---

[8]The Indiana production grant was eliminated as of July 1, 1986.

[9]The Court has also stressed "that a tax must have what might be called internal consistency—that is, the [tax] must be such that, if applied by every jurisdiction, 'there would be no impermissible interferences with free trade.'" *Armco v. Hardesty*, 467 U.S. at 644. *See also Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue*, 107 S. Ct. 2810, 2820 (1987); *American Trucking Ass'ns, Inc. v. Scheiner*, 107 S. Ct. 2829 (1987). Here, if reciprocity were insisted upon by every state, free trade areas would be created in which only those businesses whose state gave exactly the same amount of tax credit to out-of-staters would be able to compete fully in each other's states. More-

(Continued on following page)

II. THE OHIO FORCED RECIPROCITY AMENDMENT IS NOT JUSTIFIED BY A CONSTITUTIONALLY VALID PURPOSE.

Appellees, and particularly the State of Ohio, have tried to argue that the purpose of the 1984 amendment requiring reciprocity was the promotion of health; Appellees Limbach and Withrow submitted a Proposed Finding to that effect.[10]

The trial court did not make such a finding. Instead, it found two other purposes: "promoting domestic industry *and* to affect the policies of other states to grant reciprocal tax credits." J. St. App. 63a (emphasis in original). The trial court considered these "debatedly" legitimate, but in the context of a mandatory reciprocity provision, they are not even that.

"Promoting domestic industry" is a facially obvious purpose of Ohio R.C. 5735.145 (B), and the record reinforces that. But that implies nothing as to the legitimacy of the statute, for everything turns on the means, and discrimination against out-of-state business is not an acceptable means.[11] States may not 'build up [their] domestic commerce by means of unequal and oppressive burdens upon the industry and business of other States.' *Guy v. Baltimore*, 100 U.S. 434, 25 L. Ed. 743 (1880)." *Bacchus Imports v. Dias*, 468 U.S. at 272; see also *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. at 329.

Ohio's reasons for wanting to "promote" South Point Ethanol, the only member of the "domestic [ethanol] industry" are obvious and indeed indisputable, as is the fact that the ethanol tax credit statute was amended in 1984 to require reciprocity for that very purpose.

South Point has an annual capacity of some 60,000,000 gallons of ethanol, of which 41% was sold in the Ohio market in 1984, or some 22-23 million. JA 132 New Energy, with approximately the same capacity, considered Ohio one of its two potential major markets, for obvious reasons of proximity and low freight costs. New Energy planned to sell approximately 1.7. million gallone a month to wholesalers and retailers in Ohio or about 20.4 million gallons annually (JA 63-64), and already had contracts. New Energy thus presented a direct competitive threat to South Point.

(Continued from previous page)

over, the effect would vary at different times, and would thus "depend on the shifting incidence of the varying tax laws of the various states at a particular moment." The effect of Ohio R.C. 5735.145(B) on Indiana producers would have been different in 1983, when Indiana gave a credit, from what it was in 1984, when Indiana did not, and the effect on Illinois producers is different now that Illinois has reduced its credit, from what it was before the reduction. Moreover, Ohio is reducing its credit over the next few years, and this will also affect the situation. "The immunities implicit in the Commerce Clause and the potential taxing power of a state could hardly be made to depend, in the world of practical affairs, on such variable relationships." *Freeman v. Hewitt*, 329 U.S. 249, 256 (1946); *Armco v. Hardesty*, 467 U.S. at 648; *Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue*, 107 S. Ct. at 2817 n.11.

[10] JA44.

[11] Promoting domestic industry by discriminatory taxes is unacceptable even under the looser rational basis standards of the Equal Protection Clause. *Metropolitan Life Ins. Co. v. Ward*, 470 U.S. 869 (1985).

Nor is South Point Ethanol simply another private business to the Ohio legislature. The company, which was formed in 1981 with an investment of $120 million when the Ohio economy was seriously depressed, provides 191 jobs in an area with some of the highest unemployment rates in the state. JA 128 South Point has a payroll of $6 million annually, and it provides additional employment for 20-40 outside consultants. South Point also buys a great deal of corn from Ohio farmers, and uses 180,000 tons of coal per year, much of which is likely to come from Ohio. Its overall budget is almost $100 million. JA 150, 130 Finally, the State of Ohio Public Employees Retirement System loaned South Point $23.5 million to retrofit and operate its plant.

All of this was brought to the attention of the Ohio legislature in 1984 in support of the amendment, as follows:

> "Q. Did you tell them about the benefits of the South Point Plant?"
>
> "A. Yes, I stressed the development of the South Point project and used a table similar to defendant's Exhibit C to stress the economic impact of the South Point Plant." (Testimony of South Point General Manager Lauren Hill.)

JA 136

Ohio's "promoting [this particular] domestic industry" against a new competitive threat is thus very understandable.

Protection against New Energy's competition in Ohio was not the sole purpose, however, as the trial court found. South Point, which apparently saw neighboring Indiana with its very substantial ethanol consumption as a very

rich market for its ethanol, was about to lose a sales credit in that market, as a result of the oil companies' success in getting the Indiana credit repealed. It therefore sought to put intense pressure on New Energy to "affect" the policy of Indiana and to persuade it "to grant reciprocal tax benefits" to South Point.

Here again, it is indisputed that this was the purpose. As witnesses for both new Energy and South Point Ethanol testified, South Point Ethanol, through its General Manager Lauren Hill, was "lobbying heavily for it [R.C. 5735.145(B)] so they would put pressures on Indiana and perhaps on me [New Energy's President] for some number in Indiana for them at the pump." JA 123 South Point General Manager Hill, who testified for South Point Ethanol at the hearings on the 1984 amendment, confirmed this:

> "Q. Basically your support of the reciprocity clause was for the purpose of having Ohio legislation that would put pressure on Indiana to pass legislation?"
>
> "A. Well, my support of the, including the reciprocity clause with all of these changes was as an incentive to all states to enact all legislation that would promote the sale of ethanol in their states."

JA 139 *See also* JA 136. Obviously, the "incentive" was the "pressure" created by putting an Indiana ethanol producer like New Energy at a competitive disadvantage with South Point Ethanol in the Ohio ethanol market, unless the Indiana legislature did what Ohio wanted it to do. And if New Energy failed to persuade the Indiana legislature to reinstate the credit, New Energy would simply

lose the Ohio market, hardly something to upset either the Ohio legislature or South Point.

Indeed, Indiana was probably the only target since South Point's other major market—Kentucky—already had a tax credit at least as high as Ohio's, as did Tennessee and Illinois, the two other states, in which ethanol was produced and sold in Ohio, and in which South Point sold. Only Indiana no longer had any credit, and thus only Indiana was likely to be immediately affected by the legislature.

"Affect[ing] the policies of other states" is not an inherently illegal purpose. But when it is sought through discriminatory or other coercive means, it is unacceptable under the Commerce Clause. Ever since *Baldwin v. Seelig*, it has been undisputed that a state "has no power to project its legislation into another state to force the latter to adhere to the first state's policies." 294 U.S. at 521. While reciprocity may be acceptable, "forced reciprocity" is not. *A&P*, 424 U.S. at 378-80. "One state may not put pressure of that sort upon others to reform their economic standards." *Baldwin v. Seelig*, 294 U.S. at 524. *See also Brown-Forman Distillers v. N.Y. State Liquor Auth., supra* (New York cannot force producers in other states to give up their competitive advantage).

The 1984 amendment may also be seen as retaliation against the Indiana-based New Energy for repeal of the Indiana credit and enactment of a production grant: the Ohio legislation resulted from the Indiana repeal and was designed to overturn it. Such "protectionist retaliation" is clearly forbidden by the Commerce Clause. *A&P*, 424

U.S. at 379-80; Regan, 84 Mich. L. Rev. at 1114-15, 1137; Eule, *Laying the Dormant Commerce Clause to Rest*, 91 Yale L. J. 425 (1982). There is obviously nothing wrong with either Indiana's repeal of the credit, or its creating a production grant, and even if there were, Ohio's remedy is a lawsuit, not discriminatory legislation. *A&P*, 424 U.S. at 379-80; *Sporhase v. Nebraska*, 458 U.S. at 958 n. 18.

In the courts below, the State and South Point Ethanol tried to argue that the amendment was passed to increase the use of ethanol and thereby reduce pollution in Ohio. It will be noted that neither the trial Court nor the Court of Appeals accepted this contention, despite the state defendant's Proposed Finding (and even that only suggested it was "conceivable") and in the Ohio Supreme Court there is only a passing reference, somewhat ambiguously suggesting this as one of the purposes.[12]

The record is barren of any support for this contention apart from a few almost casual references to the advantages of lead-free gasoline. Not only did the trial court and the Court of Appeals decline to find this as a purpose,[13] but it is patently implausible that this was a purpose of the forced reciprocity amendment. If Ohio wants to encourage the use of ethanol, Ohio would not exclude any

[12]*See* the reference to "Ohio's interest in reducing lead pollution." J. St. App. 10a.

[13]The trial court's finding of purposes, quoted above, came immediately after stating appellees' health purpose claim and pointedly omitted health among its findings, while the Court of Appeals nowhere mentioned health as a purpose. *See* J. St. App. 42a (stating the purposes).

ethanol producer from *anywhere*, by denying the credit. Nor would it deny the credit to ethanol businesses whose states have used methods other than a tax credit to promote the use of ethanol. Moreover, Ohio would not insist that any tax credit granted by another state be as high as Ohio's for the other state's ethanol business to avoid being put at a competitive disadvantage in Ohio.

Indeed, if Ohio were really serious about using the credit to encourage the use of ethanol, it would not limit the credit to ethanol made with grain—which is produced in Ohio—and exclude ethanol made from beet or cane sugar, *i.e.*, ethanol not made in Ohio. It would not limit its credit to ethanol made from plants fired with coal—which Ohio mines—or wood, and exclude ethanol made from plants that are gas-fired. And it would not limit the grant to plants with a capacity below 200,000,000 gallons.

The fact is that ethanol use has grown even in states without credits. Of the states that use the most ethanol, Indiana gives none and most give only 1¢ (Iowa and Illinois). Ohio itself is not even among the states in which ethanol accounts for 20% or more of the market share, see p. 8 *supra*, although most of its neighbors, including states with no credit like Indiana and Michigan, and states with a very low credit, like Illinois, are among that group. This health argument is further undermined by the fact that if Ohio's purpose was to induce those states with companies that sold in Ohio to encourage the use of ethanol by giving a credit, it was unnecessary. As the Supreme Court of Ohio said, the major sellers in Ohio were from Illinois, Tennessee and Indiana, see J. St. App. 9a, and at the time reciprocity was introduced into the Ohio tax structure, Illinois and Tennessee already gave

credits to Ohio ethanol at least as high as Ohio's credits. See App. 1a. Only Indiana *could* be affected, and Indiana was encouraging ethanol use in other ways. Indeed, at the time of suit, Indiana already had some 30% of its fuel in gasohol, JA 69-70, despite elimination of the credit, and it has always been among the highest users. See CRS Study 4. Thus, the Ohio reciprocity condition was unnecessary for any purpose but the obvious one: to help South Point compensate for lost profits in the Indiana market, where, by the time of trial, six months after New Energy began operations and three months before the scheduled repeal of the Indiana tax credit, South Point's sales had fallen by about one-third. JA 132-33

As the Court noted in *A&P*, *Hunt*, *Westinghouse*, and many other cases, the State's claim that it is furthering an acceptable purpose would be more persuasive if the provision in question actually implemented the asserted goal.

Even if there were a legitimate health goal, it must be sought by the "least restrictive alternative," in keeping with "the strictest scrutiny," applicable to such facially discriminatory legislation. *Sporhase v. Nebraska*, 458 U.S. 958; *Dean Milk*, 340 U.S. at 354; *Baldwin v. Seelig*, 294 U.S. at 524; *Deukmejian v. Nat'l Meat Ass'n*, 734 F.2d 656 (9th Cir. 1984), *aff'd*, 105 S.Ct. 768 (1985). As indicated above, there are many other ways to promote the use of ethanol that are less harmful to interstate Commerce.

III. THE EFFECT OF R.C. 5735.145(B) IS TO BURDEN COMMERCE EXCESSIVELY.

Even if, unlike R.C. 5735.145(B), a statute regulates evenhandedly and treats all equally, there may still be a

violation of the Commerce Clause if "the burden on interstate Commerce exceeds the local benefits." *Pike v. Bruce Church*, 397 U.S. at 142. The only legitimate "local benefits" that are even remotely relevant are health-related, since protecting local industry at the expense of interstate commerce, or trying to force other states to provide benefits to that local industry, are each illegitimate purpose. Here, the burden far exceeds any possible health benefits for the reasons discussed above.

The Ohio Supreme Court sought to buttress its conclusion that there was no excessively harmful effect on commerce, a contention discussed under Point I hereof, by positing a hypothetical case in which Ohio R.C. 5735.145(B) was enacted, even though no Ohio firm produced ethanol. In that case, all the ethanol would come from out-of-state firms entitled to the full discount and "producers from states without a reciprocal program would, as appellant, still be at a disadvantage"—a recognition incidentally, that the statute does disadvantage appellant. If an Ohio producer then enters the market, it is on an even basis with the other competitors in the market, and such "identity of treatment for in state and out-of-state producers is the very essence of the Supreme Court's standard for 'evenhandedness.' " J. St. App. 8a.

Hardly. Apart from the fact that the forced reciprocity amendment was passed with an Ohio producer already in the market, able and indeed likely to benefit (the trial court found, of course, that the very purpose of the statute was to benefit an existing Ohio producer) the Ohio Supreme Court's logic would explain away every reciprocity case like *A&P*, as well as other cases such as *Hunt*, *Lewis v. BT Inv. Mgrs., Inc.*, and *Baldwin v. Seelig*, where a

state discriminates against some but not all interstate commerce. Thus, if there were no North Carolina apple growers, only Washington apples would be at a disadvantage and apples from other states outside North Carolina would occupy the market on an even basis with North Carolina's apples when the latter enter the market. Similarly, if there were no Mississippi milk producers, milk from states that accept the reciprocity condition would come into Mississippi, but not milk from those states like Louisiana and Alabama that had refused to do so, and when Mississippi started to produce milk, producers from the first group of states would be treated the same as Mississippi producers. And finally, if there were no milk producers in New York, producers from states where the milk was priced no lower than New York's price floor would occupy the New York market, and the subsequent entry of a New York producer would also treat them all "evenhandedly."

The fact that there is an Ohio competitor here already in the market, able and indeed likely to benefit, distinguishes this case from the statute in *Exxon Corp. v. Maryland*, which *was* passed in the absence of any Maryland competitor and was in no way designed to help *local* competitors, and could not affect the flow of interstate gasoline. *See* Note, *The Supreme Court, 1977 Term*, 92 Harv. L. Rev. 66, 71n.40 (1978). The statute in *Exxon* was designed for certain legitimate economic purposes in no way related to competition between in-state and out-of-state competitors. Whatever incidental harm there was to interstate commerce was not only minor and fortuitous but probably unavoidable, if the service station industry was to be restructured so as to exclude refiners and producers,

no matter what their home state, from service station ownership. The statute therefore met the "least drastic alternative" requirement of *Dean Milk.* The same holds for *Minn. v. Clover Leaf Creamery, Co.,* 449 U.S. 456 (1981) and *CTS Corp. v. Dynamics Corp.,* 107 S. Ct. 1637 (1987), which also involve even-handed treatment that is indifferent to the source of the competing entities. Under the Ohio statute, by contrast, the burden on interstate competitors is the purpose, effect and explicit target.

CONCLUSION

The decision of the Supreme Court upholding the 1984 mandatory reciprocity amendment, Ohio Rev. Code 5735.145(B), should be reversed and the amendment should be held unconstitutional under Art. I, § 8, cl. 3 of the Constitution.

Respectfully submitted,

HERMAN SCHWARTZ*
207 Myers Hall
4400 Massachusetts Ave., N.W.
Washington, D.C. 20016
202/885-2648

DAVID J. YOUNG
MURPHEY, YOUNG AND SMITH
250 E. Broad Street
Columbus, Ohio 43215
614/228-4371

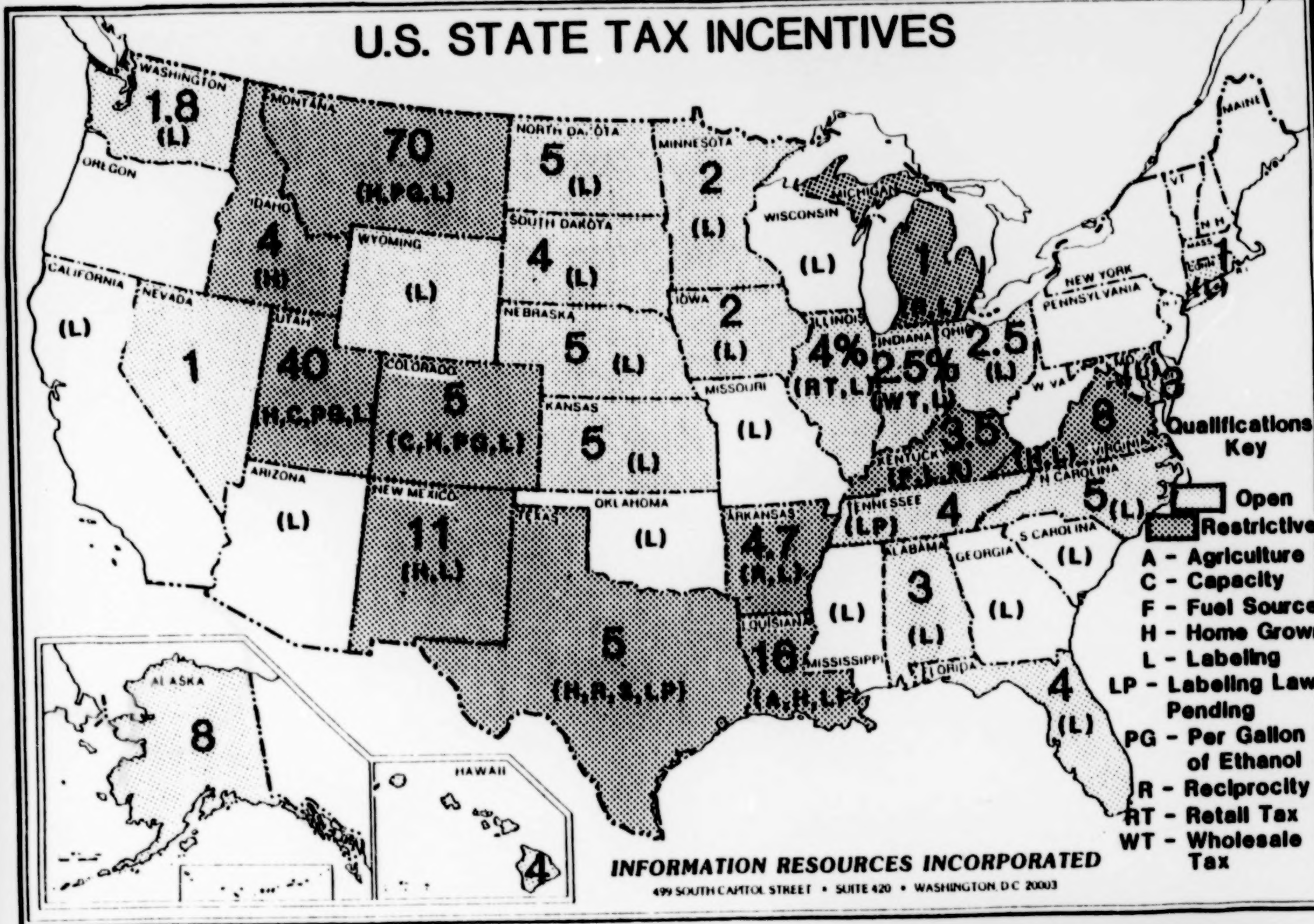
Attorneys for Appellant New Energy Company of Indiana

*Counsel of Record

January 15, 1987

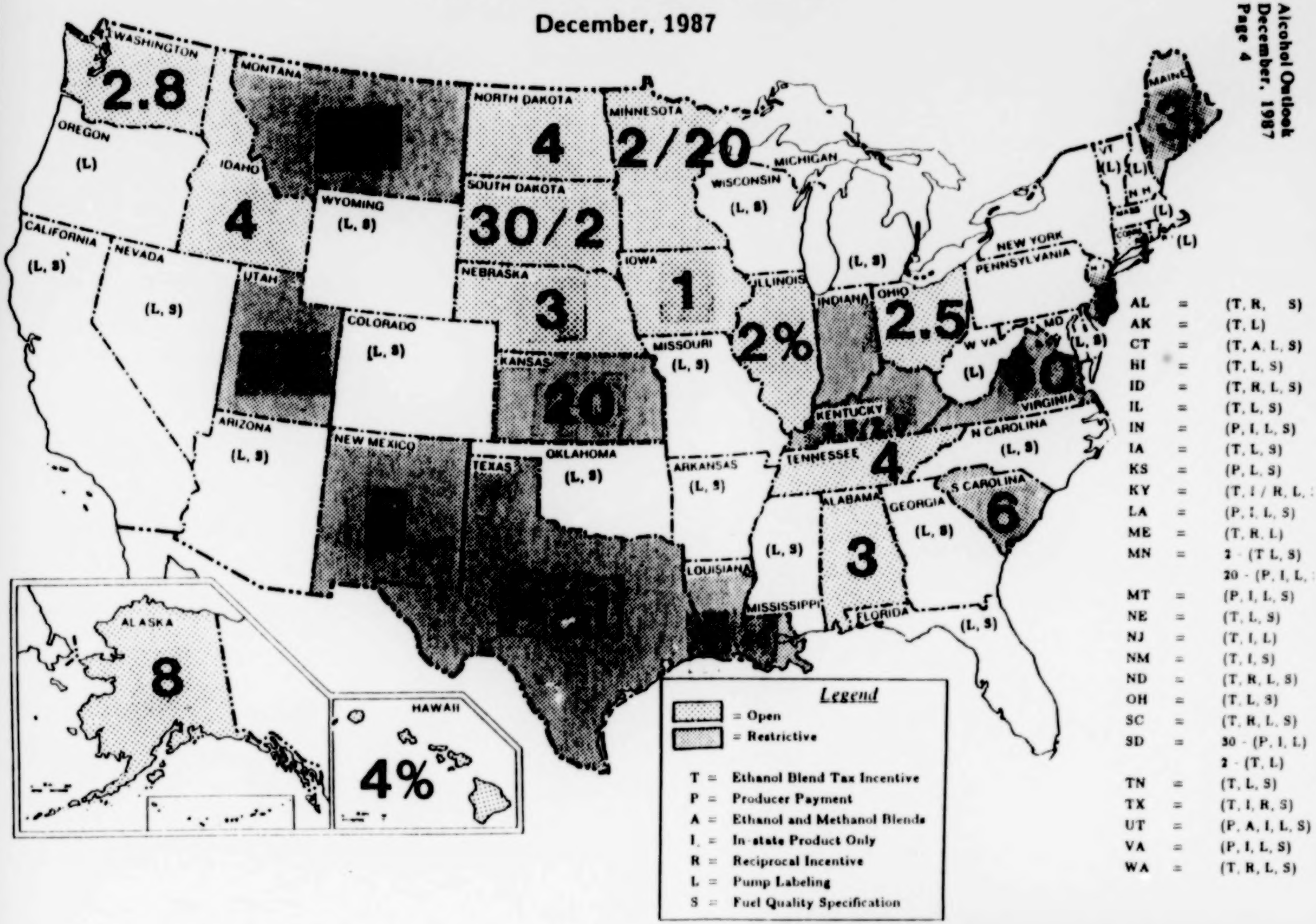
APPENDIX

1a


U.S. STATE TAX INCENTIVES
WASHINGTON
1.8
(L)
OREGON
MONTANA
70
(H,PG,L)
NORTH DAKOTA
5
(L)
MINNESOTA
2
(L)
IDAHO
4
(H)
SOUTH DAKOTA
4
(L)
WYOMING
(L)
WISCONSIN
(L)
MICHIGAN
1
MAINE
VT
N H
MASS
1
NEW YORK
PENNSYLVANIA
CALIFORNIA
(L)
NEVADA
1
UTAH
40
(H,C,PG,L)
COLORADO
5
(C,H,PG,L)
NEBRASKA
5
(L)
IOWA
2
(L)
ILLINOIS
4%
(RT,L)
INDIANA
2.5%
(WT,L)
OHIO
2.5
(L)
W VA
KANSAS
5
(L)
MISSOURI
(L)
KENTUCKY
3.5
VIRGINIA
8
ARIZONA
(L)
NEW MEXICO
11
(H,L)
TEXAS
5
OKLAHOMA
(L)
ARKANSAS
4.7
(R,L)
TENNESSEE
(LP)
4
N CAROLINA
5
(L)
S CAROLINA
(L)
ALABAMA
3
(L)
GEORGIA
(L)
MISSISSIPPI
(L)
LOUISIANA
16
(A,H,LP)
FLORIDA
4
(L)
ALASKA
8
HAWAII
4
Qualifications Key
Open
Restrictive
A - Agriculture
C - Capacity
F - Fuel Source
H - Home Grown
L - Labeling
LP - Labeling Law Pending
PG - Per Gallon of Ethanol
R - Reciprocity
RT - Retail Tax
WT - Wholesale Tax
INFORMATION RESOURCES INCORPORATED
499 SOUTH CAPITOL STREET • SUITE 420 • WASHINGTON, D.C. 20003

State Fuel Incentives & Regulations

December, 1987



5735.145. Credits for use or sale of qualified fuels.

(A) AS USED IN THIS SECTION AND SECTIONS 5735.13, 5735.14, 5735.141, 5735.142, 5735.146, AND 5735.17 OF THE REVISED CODE.

(1) "[qualified]* QUALIFIED fuel" means [alcohol]* ETHANOL that is to be combined with gasoline to create a blend of not more than ten per cent by volume of [alcohol and]* ETHANOL AND THAT WHEN SO BLENDED is used, sold or distributed as a motor vehicle fuel. ["Alcohol" includes ethanol and methanol but does not include alcohol produced from natural gas or petroleum. "Alcohol" does include methanol produced from coal.]*

(2) "ETHANOL" MEANS:

(a) ETHANOL PRODUCED IN A MANUFACTURING FACILITY WITH AN ANNUAL PRODUCTION CAPACITY OF LESS THAN TWO MILLION GALLONS FROM WOOD OR THE GRAIN OF A CEREAL GRASS AND DENATURED IN ACCORDANCE WITH UNITED STATES BUREAU OF ALCOHOL AND TAX REGULATIONS; OR

(b) ETHANOL PRODUCED THROUGH A COAL-FIRED PROCESS FROM WOOD OR THE GRAIN OF A CEREAL GRASS AND DENATURED IN ACCORDANCE WITH UNITED STATES BUREAU OF ALCOHOL AND TAX REGULATIONS.

(3) "FEDERAL GASOHOL CREDIT" MEANS THE AMOUNT PER GALLON ON THE LAST DAY OF EACH MONTH BY WHICH THE FEDERAL TAX ON GASOLINE EXCEEDS THE FEDERAL TAX ON GASOHOL IMPOSED UNDER 26 U.S.C.A. 4081.

(4) "QUALIFIED FUEL CREDIT" MEANS THIRTY-FIVE CENTS PER GALLON OF QUALIFIED

---

* Bracketed material deleted.

FUEL MINUS THE AMOUNT PRODUCED BY THE FOLLOWING COMPUTATIONS:

(a) SUBTRACT FIVE CENTS FROM THE FEDERAL GASOHOL CREDIT. IF THE DIFFERENCE IS A NEGATIVE NUMBER, THE QUALIFIED FUEL CREDIT SHALL BE THIRTY-FIVE CENTS, AND NO FURTHER COMPUTATIONS SHALL BE REQUIRED.

(b) MULTIPLY THE DIFFERENCE THUS OBTAINED BY TEN. IF THE PRODUCT EXCEEDS THIRTY-FIVE CENTS, THE QUALIFIED FUEL CREDIT SHALL BE ZERO.

THE TAX COMMISSIONER SHALL MAKE SUCH COMPUTATIONS ON THE FIRST DAY OF EACH MONTH, AND THE RESULT OF SUCH COMPUTATIONS SHALL BE THE CENTS PER GALLON QUALIFIED FUEL CREDIT FOR THAT MONTH AND EACH MONTH THEREAFTER UNTIL THE AMOUNT OF SUCH CREDIT IS CHANGED BY THE COMPUTATIONS REQUIRED BY THIS DIVISION.

(B) THE QUALIFIED FUEL OTHERWISE ELIGIBLE FOR THE QUALIFIED FUEL CREDIT SHALL NOT CONTAIN ETHANOL PRODUCED OUTSIDE OHIO UNLESS THE TAX COMMISSIONER DETERMINES THAT THE FUEL CLAIMED TO BE ELIGIBLE FOR CREDIT CONTAINS ETHANOL PRODUCED IN A STATE THAT ALSO GRANTS AN EXEMPTION, CREDIT OR REFUND FROM SUCH STATE'S MOTOR VEHICLE FUEL EXCISE TAX OR SALES TAX FOR SIMILAR FUEL CONTAINING ETHANOL PRODUCED IN OHIO; PROVIDED HOWEVER, THAT SUCH CREDIT SHALL NOT EXCEED THE AMOUNT OF THE CREDIT ALLOWABLE FOR QUALIFIED FUEL CONTAINING ETHANOL PRODUCED IN OHIO.

(C) Any dealer in motor vehicle fuel shall receive a credit on each gallon of qualified fuel used, sold, or distributed by the dealer and on which the dealer is liable for

the taxes imposed by sections 5735.05, 5735.25, 5735.29, and 5735.30 of the Revised Code. To receive a credit, the dealer shall certify on the monthly report required by section 5735.06 of the Revised Code the number of gallons of qualified fuel used, sold, or distributed during the month to which the report applies and upon which such taxes are imposed. After computation of the amount of the tax in accordance with division (B) of section 5735.06 of the Revised Code, the number of gallons of qualified fuel used, sold, or distributed during the month to which the report applies and included in the gallons of motor vehicle fuel upon which the tax is imposed shall be multiplied by [thirty-five cents.]* THE CENTS PER GALLON QUALIFIED FUEL CREDIT APPLICABLE TO THAT MONTH. The resulting product shall be subtracted from the tax computed under division (B) of section 5735.06 of the Revised Code and shall constitute the credit provided by this section.

* Bracketed material deleted.